CLASSIFICATION OF FINANCIAL INSTITUTIONS ACCORDING TO METHOD OF OPERATION

Method of Operation	Commercial	Investment
Deposit	Commercial bank	Savings bank Co-operative institutions Savings and loan association Building and loan association Credit union
Mediation		
1. Pure broker (sell on commission)	Foreign exchange broker Note broker	Stock broker Mortgage broker
2. Buy and sell without indorsement	Commercial paper dealer Acceptance dealer	Investment banker
3. Buy and sell with indorsement	Cattle loan company (feeder loans)	Cattle loan company (stocker loans) Investment trust
4. Buy and sell own obligations	Discount company—including company financing wholesale marketing of automobiles	Real estate mortgage banker—farm or urban Instalment financing company—including financing of retail sales of automobiles, furniture, pianos, books Investment trust
Suretyship	Acceptance house Credit insurance company	

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WAS DECONTROL OF SUGAR IN THE UNITED STATES ADVISABLE?

In his *American Citizenship and Economic Welfare* Professor Hollander reminds us that Dugald Stewart wrote to Lord Craig in 1794, "among all the interesting questions which have, during the last nine years, divided our political parties, I have never introduced the slightest reference to any of them excepting in the single instance of the African trade, on which I formerly expressed myself with some warmth—and even these expressions I dropped from my course, as soon as it became a matter of popular discussion."

Such isolation of the university economist from questions of dominant public interest and controversy is today almost as obsolete as the powdered wig. But in these days of active participation by economist and statistician in business and government, much may be accomplished in advancement of economic science if there is recorded for each concrete

instance of economic experimentation such facts, properly interpreted, as throw light upon moot points. Among the most interesting of the numerous "laboratory experiments" in political economy produced by the Great War is the course of events in the sugar market following removal of governmental control of prices and distribution.

Only the briefest historical outline is here necessary, since the complete narrative has been placed on record elsewhere by the writer.[1] In the middle of 1919, following almost two years of war-time governmental control of sugar prices and distribution, first through the United States Food Administration, then through its offspring the United States Sugar Equalization Board, Inc., a decision had to be made as to the mechanism of decontrol. The Sugar Equalization Board received a letter on July 29, 1919, from the Cuban commissioners, tendering to the government of the United States the Cuban sugar crop for 1920. Inasmuch as the authority of the Board did not extend beyond the purchase and distribution of the 1919 crops, its directors placed the matter before President Wilson in a memorandum dated August 14, 1919, the concluding paragraph of which was as follows:

> Conditions are so abnormal and the prospect of securing a regular supply of sugar at a reasonable price for the people of the United States for the year 1920 is so uncertain that the Equalization Board concludes, from a commercial point of view, that its duty requires it to suggest to the President, that, in reply to the communication from the representatives of Cuban producers, negotiations be entered into for the purpose of securing the sugar required for the necessities of the people of the United States for the year 1920 from Cuba under somewhat the same arrangements as the Equalization Board was able to make with the Cuban commissioners and producers and the refiners in the United States for the year ending December 31, 1919. This suggestion is made entirely from our consideration of the sugar situation from its standpoint of assuring the American people a regular supply at a reasonable price and, of course, is subject to the general policy of the Government as to the advisability of continuing control and regulation of food commodities.[2]

In a letter accompanying the memorandum, the directors urged "that the Cuban commission should be advised at an early date as to whether our Government proposes to consider this tender." Professor Taussig, who was one of the Board's directors, submitted a dissenting view along with the foregoing memorandum which was as follows:

[1] See articles in the *Quarterly Journal of Economics*, August, 1918 and 1919, and *Government Control of Sugar*, Macmillan Co., 1920.

[2] *Government Control of Sugar*, p. 114.

I regret not to be able to reach the same conclusion as the other members of the Sugar Equalization Board. I believe that no negotiation should be entered in with the Cuban producers, and that the regulation and restriction of sugar prices should cease with the close of the present arrangement, December 31.

It is true that the evidence now available points to a shortage of sugar in 1920 and to a possibility of prices in that year as high as those of 1919, or even higher. But no certain conclusions can be reached about the future. Prices of sugar will be affected not only by the incoming supplies, but by the general political and monetary conditions of the whole world. The general level of prices in the United States and in other countries may be lower than it is now. Consumption may be reduced by changes in general business conditions or by restrictive measures in importing countries. The present recommendation of the board is that the United States (through the board) should repeat a huge commercial venture, in the hope of protecting consumers and of incurring no loss, but with the clear possibility of having to assume a loss. The operation would involve a guarantee by the Government of extremely high profits to the Cuban sugar planters, and also a virtual guarantee of similar profits to our beet-sugar producers as well as to the planters of Louisiana, Hawaii, and Porto Rico. It would necessarily lead to contracts with the sugar refiners which would guarantee good profits to them also. No doubt in the absence of Government regulation all these producers might make profits higher still; but prediction as to the outcome one way or the other can not be made with any confidence. Business of this kind may be undertaken by the Government under stress of war, but should cease now that we are at peace.

Moreover, the regulation of the price of sugar can not in my judgment stand alone. The whole relation of Government to industry in time of peace is involved. If the price of sugar is to be specifically controlled, so should that of bread, of meat, of clothing. In the main we must look for a remedy to the natural development of production and to the return of the entire world to normal financial and economical conditions.[1]

The White House acknowledged receipt of these communications but no statement or direction was issued by the President. After waiting anxiously for nearly three months for a reply to their tender of July 29, 1919, the Cuban representatives withdrew their offer and the President of the Sugar Equalization Board thereupon notified the refiners of the situation in order that they might proceed with their purchases of raw sugar on the supposition of a return to normal market conditions at the close of the year.

Through one of those not uncommon, fallacious fixations of public opinion, it was generally assumed thereafter, and frequently stated and printed publicly, that President Wilson had followed

[1] *Ibid.*, p. 115.

Professor Taussig's counsel, and considerable criticism, much of it of a vitriolic nature, was subsequently heaped upon the latter by those who believed that the Cuban tender should have been accepted. As a matter of fact, examination of the published correspondence between the Board and the White House indicates that the President had followed neither the opinion of the majority nor Professor Taussig's views. The majority had urged acceptance of the Cuban offer, Professor Taussig had urged the opposite. Neither had proposed the intolerable policy of absolute silence which was not explained until five months later in a statement issued from the White House:

> At that time there was an expectation that the treaty of peace with Germany would be ratified within a reasonable time and that peace conditions would reappear. There appeared to be a very definite view on the part of Congressional leaders that the exercise of war power should not be extended another year. . . . . The majority of the Board was definitely of the opinion that the Cuban crop should not be bought unless it was clear that its powers of control over sugar would be effective, and this could not be made certain without action by Congress. The President had not reached a conclusion in the matter when he started on his western trip and was taken ill.[1]

This announcement, making it clear that the controversy over the peace treaty and the President's physical collapse were responsible for the delay, did not appear before the end of the year. Meanwhile an investigation by the Senate Committee on Agriculture and Forestry, begun on October 3, 1919, disclosed the significant facts in the case, and attempt was made through remedial legislation to stabilize the market which had become chaotic because of the relatively long intervening period of uncertainty concerning the government's policy for the coming crop. It was not, however, until December 20, 1919, that Congress passed the McNary bill which authorized the President to continue the Sugar Equalization Board for the year 1920 and to require the directors, if found necessary for the public good, to carry out a plan for securing an adequate supply and equitable distribution of sugar at a fair and reasonable price. The President, however, although he signed the bill, announced that it was too late to exercise the authority conferred so far as purchase of the Cuban crop by the government was concerned.[2] The uncertainty which had hitherto prevailed thus

[1] *Government Control of Sugar*, pp. 119–20. [2] *Ibid.*

ended, excitement subsided and a price decline soon set in so that by February 26, 1920, raw sugar f.o.b. Cuba had dropped to 8.74 cents a pound as against 11.62 cents in the early part of August, 1919.

Unfortunately, just at this juncture rumors that a severe drought in Cuba had shortened the crop by 500,000 tons were confirmed. Such bullish news at a time when the country was passing through the apogee of a period of inflation could have but one result—a scrambling for available supplies on the part of purchasers and a perpendicular rise in prices. From 8.74 cents per pound f.o.b. Cuba, on February 26, the price soared to the incomprehensible price of 22 cents on May 19. Public excitement became acute. Congress was flooded with protests from consumers and demands for action. Unable to legislate away the effects of the Cuban drought or to deflate the currency and credit by fiat, Congress could only feed the suffering consumer demanding lower priced sugar with new investigations. The unfortunate situation, as nearly everyone now knows, speedily adjusted itself through the familiar play of economic forces. The abnormally high price of sugar served both to discourage consumption and to stimulate importations in tremendous quantities from all parts of the world. The price of raw Cuban sugar dropped continuously and precipitously from 22 cents on May 19, 1920, to $2\frac{1}{2}$ cents in July, 1921, bringing in rapid succession in Cuba financial failure of speculators, producers, traders, and banks, and a moratorium, and severe losses to the various branches of the sugar trade in the United States.

Turning now to the lessons to be drawn from the course of events, it is clear, first of all, that a fair judgment as to the merits of the policy of decontrol cannot be made because of the intervention in the situation of that troublesome factor, economic friction (perhaps it would be more proper to say political friction in this case!) in the form of a totally unforeseen delay by both the President and Congress in rendering decision as to policy. Waiving this consideration on the rather dubious ground that economic science is exact enough to permit of making due provision for economic friction of this sort just as the physicist or chemist, for instance, makes calculation for various disturbing factors, and assuming that the delay was an inevitable part and parcel of the policy of decontrol, what has been the outcome?

That the consumer actually paid for the crop year 1919–20 a price for sugar much in excess of what would probably have been the price under control is clear from a comparison of the Bureau of Labor Statistics' monthly relatives of the retail prices of sugar for the period from January, 1913, to June, 1921, with relatives for all food articles combined, as shown in the following table:

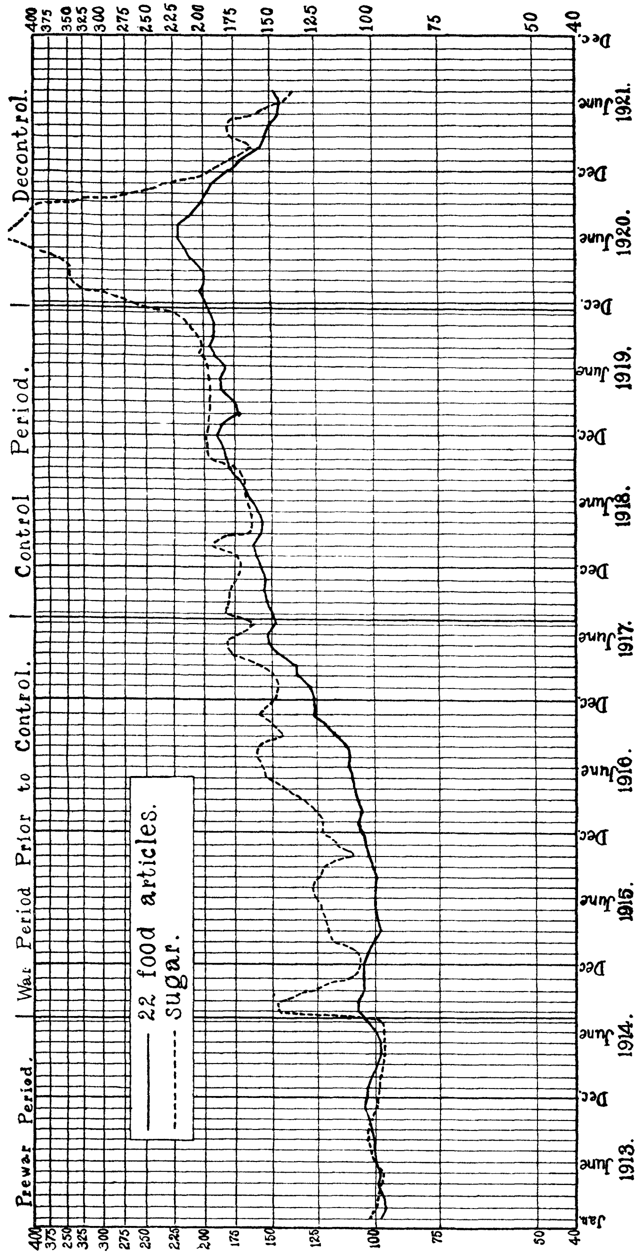
TABLE AND CHART COMPARING TREND OF RETAIL PRICES OF TWENTY-TWO FOOD ARTICLES COMBINED, WITH TREND OF RETAIL PRICE OF SUGAR

(Average Cost for 1913 = 100)

	1913		1914		1915		1916		1917		1918		1919		1920		1921	
	Sugar	22 Food Articles	Sugar	22 Food Articles	Sugar	22 Food Articles	Sugar	22 Food Articles	Sugar	22 Food Articles	Sugar	22 Food Articles	Sugar	22 Food Articles	Sugar	22 Food Articles	Sugar	22 Food Articles
January..	106	98	95	104	110	103	123	107	146	128	173	160	196	185	324	201	176	172
February.	100	97	94	101	118	101	125	106	148	133	193	161	195	172	342	200	162	158
March...	99	97	93	99	120	98	137	107	160	133	167	154	193	175	340	200	176	156
April.....	98	98	91	97	122	99	145	109	175	145	165	154	193	182	367	211	176	152
May.....	97	97	91	98	124	100	156	109	183	151	165	158	193	185	462	215	153	145
June.....	97	98	93	99	126	100	158	112	170	152	165	162	193	184	485	219	142	144
July......	100	100	95	102	127	100	160	111	166	146	167	167	198	190	482	219	129	148
August...	102	101	143	107	123	100	155	113	181	149	169	171	202	192	416	207	....	....
September	104	102	145	107	118	101	141	118	179	153	175	178	200	188	333	203	....	....
October..	101	104	132	105	111	103	149	121	177	157	193	181	207	189	253	198	....	....
November	99	105	113	105	119	104	157	126	174	155	196	183	227	192	235	193	....	....
December	98	104	110	105	124	105	151	126	172	157	196	187	264	197	191	178	....	....
Yearly Average	100	100	108	102	120	101	146	114	169	146	176	168	205	186	353	203	....	....

In the period of control the relative for sugar was generally only slightly above the index of all food articles, whereas in the crop year 1919–20, the first year following decontrol, sugar soared far beyond, reaching its maximum of 485 in June, 1920, as against only 219 for the index of all food articles. The two sets of figures also ran much closer together in the control period than in the several years preceding.

While the policy of decontrol was thus undoubtedly costly to the consumer in the first year which followed, there resulted, on the other hand, a phenomenally rapid return to the pre-war price. The relative for sugar in July, 1921, dropped 19 points below the general food price level, a remarkable situation when it is realized that the world's sugar production is still over one and a quarter million tons below the pre-war level. Had government control been


Prewar Period.
War Period Prior to Control.
Control Period.
Decontrol.
22 food articles.
Sugar.
Jan. June Dec.
1913. 1914. 1915. 1916. 1917. 1918. 1919. 1920. 1921.
400 375 350 325 300 275 250 225 200 175 150 125 100 75 50 40

continued another year the decline in price would have unquestionably been correspondingly deferred and spread over a period of several years.[1]

At this point it is perhaps well to pause for reflection upon the outcome had the United States purchased the Cuban crop in 1919. The mere act of government purchase could not have bewitched the climate. A drought there was without governmental control, and a drought there would have been with it. Under such a condition, not even the severest discipline of a sugar "dictatorship" could have prevented a wild scramble for available supplies without the effective support of the war psychology. A "back door" sugar trade would undoubtedly have been bred overnight if the drastic war-time rationing and price-fixing had been utilized to prevent accumulation of supplies by the more necessitous or financially capable purchaser. Furthermore, in July or August, in the midst of the most unfavorable conditions, it would have been necessary to arrange for the purchase of the next year's crop or to finally liquidate governmental control. In either case, the road would have been no easy one, and it is, by no means, beyond the range of possibility that a considerable sum would have been required from the Federal Treasury to make good large losses sustained on government-owned stocks. As it actually turned out, the sugar trade itself bore the brunt of deflation and lost large sums in the process. It is not without significance in this connection that the British Royal Commission on the Sugar Supply which continued its operations through the turbulent year 1920 has reported a loss of £24,500,000 or approximately $90,221,250 at present exchange, while the United States Sugar Equalization Board terminated its operations at the close of 1919 with a profit to the Treasury of $38,000,000.[2]

In conclusion, it now seems clear that there was little advantage in the adoption of either policy in 1919, control or decontrol. In

[1] What has been said of the consumer applies also to the producer generally, continuance of control would have deferred elimination of high-cost producers. The writer realizes, of course, that deflation is not the remedy for inflation, and that a return to "normalcy" at this time may not be desirable.

[2] *The Wall Street Journal*, August 30, 1921.

either case delay by President and Congress was inevitable in rendering the final decision under the political conditions then existent, and unanticipated and unwelcome results such as followed the adoption of one policy would have unquestionably followed the adoption of its alternative. It was, after all, a problem as to whether the cost of restoring the sugar market to normal conditions was to be met in a comparatively brief period and out of the pockets of consumers, producers, and distributors jointly and directly, or instead through contribution from the public treasury supplemented by consumers' excess expenditures spread over a relatively longer period of time. On the whole, viewing the episode with the advantage of retrospect we may well congratulate ourselves that the trying initial stage of readjustment in the sugar market is over with once for all.[1]

Public attention during the period of high sugar prices was almost entirely concentrated upon fixation of personal responsibility. This is to be deemed lamentable, since an important though by no means novel lesson was thus lost: that the national executive is overburdened with detail; that Congress, as at present constituted, is unable to function as efficiently when acting in the capacity of what has been termed a "board of directors of the public corporation"[2] as when engaged in the simpler rôle of a purely law-making body; and that, in consequence thereof, neither the President nor Congress is able to arrive at a business decision with sufficient promptness to make governmental participation in private enterprise a success. Reorganization and simplification of the machinery of the federal government must clearly precede any increase in the scope of its activities in this direction.

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[1] It is not meant here to imply that the comparatively early liquidation of general war-time food control was wise. The writer has in fact noted elsewhere that a costly error was made thereby (*New York Evening Post*, June 23, 1920).

[2] Willoughby, *The Government of Modern States*, p. 301.